

## COMPOSITION OF SUPERVISORY COMMITTEES IN TRINIDAD AND TOBAGO CREDIT UNIONS

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### Abstract

This paper provides an assessment of the competence and independence of members of the supervisory committee (SC) of Trinidad and Tobago (T&T) Credit Unions (CUs), and examines factors that are associated with SC chairpersons' competence and independence. Most of the information used in the paper was collected by conducting structured interviews with the immediate-past chairperson of the supervisory committees of 58 T&T CUs. The results of the analysis indicate that the overall level of financial literacy, financial expertise and independence among SC chairpersons was relatively low. The SC chairpersons of community-based CUs tended to be significantly more financially literate than their counterparts in organizationally-based CUs. Also, the results suggest that the independence of SC chairpersons varied negatively with CU Size.

**Key words:** Supervisory Committee, Credit Union, Trinidad and Tobago, Corporate Governance, Financial Literacy, Expertise, Independence

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### Introduction

According to Monk and Minow (2004: p. 2) "a corporate governance (CG) system is composed of structures intended to ensure that the right questions get asked," at the appropriate times, "and that checks and balances are in place to ensure that the answers reflect what is best for the creation of long-term, sustainable value." When these systems breakdown, the likelihood of divergence between the interests of managers and other organizational stakeholders increases, exposing the organization and the wider community to dysfunctional managerial behaviour, economic losses and failure (Jensen & Meckling, 1976); as exemplified by the recent experiences of former business giants such as Parmalat and Enron.

Unfortunately, similar events have been observed in the credit union sector. For instance, the Canadian Broadcasting Corporation (CBC 2007) reported on a CA\$ 31.5 million bailout of Caisse Populaire de Shippagan Credit Union by the Canadian government to prevent its liquidation. The Credit Union had accumulated losses of CA\$ 60 million in four years due to lax risk assessment and management.

Similar incidents of poor governance and mismanagement of CUs have been reported in Pakistan (Hussain 1992), the United Kingdom (Davidmann 1995), the USA (NCUA, 1996;

D'Amours and Isaac, 2005; Diekmann, 2006), Japan (Brull, 1995) and T&T.

For instance, in 2006 the current Minister of Finance had to intervene to settle a dispute between the Board of Directors (BOD) and the Supervisory Committee of Eastern Credit Union (one of the largest CUs in T&T) in the face of allegations of excessive perquisites being paid to directors (West, 2007).

Additionally, in 2001 the then T&T Minister of Finance, Gerald Yetming highlighted excessive loan delinquency and outdated business practices as factors that limit the ability of CUs to serve members effectively (Rampersad, 2001). He suggested that these deficiencies were widespread in the CU sector and, had contributed to the liquidation of seven CUs between 1998 and 2001.

Unfortunately, this presumed widespread weakness of corporate governance in T&T CUs has not been supported by systematic research evidence. Instead, commentators have relied primarily on anecdotal evidence to support their assertion. A comprehensive review of the academic literature in the English-speaking Caribbean was unable to find a single systematic study of corporate governance in CUs.

The paucity of research regarding governance in CUs is troubling when one considers the importance of CUs to the economic well being of a large segment

of the most vulnerable section of the population in T&T and many other countries. Also, CUs control substantial financial and physical resources; a large component of which is liquid and vulnerable to misappropriation. Thus, it is imperative that CUs manage their resources efficiently and effectively.

When these factors are viewed in the light of the previously described incidents of financial impropriety experienced by CUs, and the need for them to compete in an increasingly global financial services sector, they point to an urgent need for remedial action. This assessment is apparently shared by the Trinidad and Tobago government which recently initiated proceedings to upgrade the law governing the operations of CUs. Among the measures being proposed is a requirement for all members of the BOD and officers to meet and maintain “fit and proper” criteria including honesty, integrity, fairness, competence, diligence, soundness of judgement and personal financial soundness (CBTT, 2007). The CBTT also proposes that individual CUs will be responsible for monitoring the fitness and propriety of their board members and officers.

This study attempts to facilitate this initiative by assessing the extent to which SC members meet the competence element of the “fit and proper” criteria proposed by the CBTT and the independence requirement of the Cooperative Society Act (1971). It looks at the readiness of CUs for the impending changes in their regulatory requirements. Also, this study examines whether the composition of SC is influenced by CU size and Type, two factors that have been linked to other aspects of CU governance. The findings of this study will provide baseline information that can be used to evaluate the effectiveness of new regulatory requirements on CU governance.

The remainder of the paper is organised as follows. Section II describes the CU environment of Trinidad and Tobago. Section III describes the nature and purpose of corporate governance. Section IV describes two major factors that have been proposed as determinants of the composition of SC in CUs. Section V describes the research methodology. Section VI presents the results of the data analyses, and section VII discusses the implications and limitations of the findings.

### **Credit Union Environment**

CUs are financial consumer co-operatives that provide depository, credit, group purchasing plans and related financial services to members on terms that are generally more favourable than those available from other financial institutions. They are found in at least 79 countries and have a membership in excess of 118 million persons (Arnold 2004).

Though the primary objective of CUs is not profit maximization like the typical commercial organization, they are purpose driven and must

generate operating surpluses to survive and prosper. Therefore, their decisions must reflect appropriate cost-benefit considerations.

Generally, CUs cannot do business with the general public due to the nature of their charter which limits them to serving a membership that has some common bond. In Trinidad and Tobago (T&T) there are 131 active CUs with an asset base of approximately TT\$4,067m (TT\$6.33 = US\$1) and a membership of more than 400,000 (Co-operative Development Division 2005).

Currently, T&T CUs are regulated by the Co-operative Division under the Co-operative Societies Act (CSA, 1971). However, plans are at an advanced stage to strengthen the CU legislation and regulations and, to transfer supervision to the CBTT which has access to more and better resources (Bowrin 2007).

### **Nature and Purpose of Corporate Governance**

This need for effective CG systems to protect shareholders has traditionally been explained using agency theory which views an organization as the intersection of contracts among owners of the factors of production. According to agency theory these contracts are necessary because decision management skills are not a necessary consequence of wealth or willingness to bear risk, and do not necessarily reside with the average CU member. As a result, specialization of decision management and residual risk bearing are established features of most “modern” CUs. This theory seems appropriate to the governance of CUs because they seek to maximize members’ value, and the majority of CU members do not play an active role in their administration. Also, agency theory has been used by Greinke (2005) to explain governance issues in Australian CU.

CU members elect individuals to the board of directors to manage the CU’s affairs. They expect, and directors and executive managers undertake to, conduct the affairs of the CU in a manner that would maximize the objectives sought by CU members. However, the problems of adverse selection and moral hazard, which are associated with information asymmetry and uncertainty, make it likely that some directors (and executive management) might be tempted to assign higher priority to objectives other than those of CU members. These challenges are likely to become more acute given the increasing professionalization of CU management and the pending introduction of prudential requirements based on minimum capital requirements (Kester, 1996; Davis, 2005). Additionally, unlike managers of publicly traded firms, the managers of CUs are not subjected to the discipline of capital markets, whether by institutional investors, significant block holders, or analysts. Further, the formation of competing control coalitions is unlikely given the one-man-one vote principle underling CU governance. This effectively removes the threat of takeover as a check on the

performance of CU managers and aggravates agency problems between owners and managers as inefficient or self-serving management can become entrenched as the nature of the property rights reduces the incentives for CU members for monitor and discipline management (Baker and Thompson, 2000). As a result, managers of CUs may lack incentives to manage efficiently as property rights are not closely defined in respect of organizational surpluses (Weisbrod and Schlesinger, 1986). Therefore, CUs implement a variety of corporate governance mechanisms to minimize the negative consequences of these potential agency problems.

SCs are a key element of the corporate governance infrastructure of CUs in many states. They, along with the other elements of the CG system are intended to resolve or mitigate problems of coordination and control caused by the fact that most CU members and other stakeholders are unable to participate actively, and or continuously in their administration and daily operations, and to protect the interest of CU members and other stakeholders from the potential self-interested behaviour of managers.

The SC is a statutory committee in T&T CUs that typically consists of at least two CU members that are elected at each Annual General Meeting. The members of the SC are not eligible to serve on the BOD, or any other committee of the CU. Typically the SC is responsible for keeping an eye on any, and all, areas where there are potential risks to the well-being of the institution, to promote its safety and soundness by ensuring that the CU complies with applicable laws, regulations and policies. Like the audit committee (AC) in public companies, the SC is the primary mechanism for assessing the adequacy of internal controls and for monitoring compliance with these controls.

To discharge these duties the SC conducts periodic (at least semiannually) examinations of CU affairs and produces an annual report that is submitted to CU members at the Annual General Meeting.

Recently, there has been considerable focus on the composition of non-for-profits' audit committees. For instance, the WOCCU (2004) stressed the importance of having independent AC members, and the AICPA (2005) highlighted the need for independence and financial expertise among AC members. Also, the World Council of Credit Unions (WOCCU) recommends financial literacy for the members of the SC (2004). Financial literacy, financial expertise and independence is also being promoted for AC members by the International Federation of Accountant (IFAC 2003). These proposals are consistent with legislative initiatives in T&T aimed at ensuring that all members of SCs meet "fit and proper" criteria. Also, the existing CU legislation requires SC members to be independent of the BOD and management.

The longstanding concern of legislators with the independence of SC members is supported by empirical evidence in the corporate governance

literature indicating that organizations with greater proportions of independent AC members are (i) less likely to be sanctioned for fraudulent or misleading financial reporting (Abbott et al., 2000); (ii) more likely to receive going concern audit opinions (Carcello and Neal, 2000) and less likely to dismiss the auditor following the receipt of a first-time going-concern modified audit opinion (Abbott et al., 2003).

Similarly, prior research suggests that ACs with at least one financial expert are (i) less likely to have suspicious external auditor shifts (Archambeault and DeZoort 2001); (ii) less likely to have financial reporting problems (Mc Mullen and Raghunandan, 1996); and (iv) more likely to focus on recurring but less prominent accounting and auditing issues (Mc Daniel et al., 2002).

### **Factors That May Influence CU Governance CU Size and Governance Quality**

We expect the composition of the SC of T&T CUs to be associated with their size. This relationship is probably due to the greater economic and political visibility of larger CUs relative to their smaller counterparts (Watts and Zimmerman, 1986; Vermeer et al. 2006), which leads to heightened scrutiny for larger CUs (Jensen and Meckling, 1976). If larger CUs are aware of their greater visibility and scrutiny, which increase the likelihood that control deviations will be detected, then we can expect larger CUs to be more likely than their smaller counterparts to have properly designed and effectively functioning corporate governance systems (Watts & Zimmerman 1986).

Also, larger CUs are likely to have lower levels of internal member bonding and members may demand closer monitoring of managers with whom they are less familiar (Greinke, 2005). Further, larger CUs have more resources (e.g., more members and a greater number of better educated members) to devote to CG than their smaller counterparts, and they may benefit for scale economies in governance-related expenditure. Additionally, larger CUs are more likely than their smaller counterparts to be audited by international auditing firms that have been associated with better audit quality (DeFond and Francis 2005). Such auditors are more likely to detect, and insist on the correction of, corporate governance weaknesses, than their local counterparts. Larger CUs are also associated with better financial reporting quality than their smaller counterparts (Hyndman et al. 2004). Based on the above arguments we offer the following predictions regarding the association between the composition of SC and CU size:

**Hypothesis IA:** The members of the SC of larger CUs are likely to be more financially literate than their counterparts in smaller CUs.

**Hypothesis 1B:** *Larger CUs are more likely to have SC members that are financial experts that are smaller CUs.*

**Hypothesis 1C:** *Larger CUs are more likely to have independent SC members than their smaller counterparts.*

### CU Type and Governance Quality

Credit Unions are frequently classified according to their common bond. Several approaches to classification appear in the literature, although the major groupings appear to be consistent, despite different labels (Greinke, 2005). In this study we use two categories adopted by regulators in the USA, occupational- and residential- (community) based CUs. Similar categories were used by Brown and O'Connor (1995). Community-based CUs are expected to have more competent and independent SC members than their organizationally-based counterparts. On average, community-based CUs are likely to have access to a larger pool of better educated, more financially literate and more sophisticated individuals as members (UWICU, 2006). Assuming these members make themselves available for election to the BOD and committees, such CUs should also have better educated and more financially literate SC members. Also, these individuals are more likely to recognize the critical role played by CG in the realization of CU mission, goals and objectives and therefore to devote more and better resources to CG. They may also better recognize the positive signalling effects that such a proactive governance disposition can have for the CU's reputation with regulators, members and other stakeholders as they are perceived as being of impeccable integrity (Technical Assistance for Community Services [TACS] 2004). Based on the above arguments we offer the following predictions about the association between CU type and the composition of SCs:

**Hypothesis 2A:** *The members of the SC of Community-based CUs are likely to be more financially literate than their counterparts in organizationally-based CUs.*

**Hypothesis 2B:** *Community-based CUs are more likely to have SC members that are financial experts than their organizationally-based counterparts.*

**Hypothesis 2C:** *Community-based CUs are more likely to have independent SC members than their organizationally-based counterparts.*

### Research Methodology

#### Sample

The sample frame consisted of all 131 active CUs in T&T in 2003. Correspondence was mailed to the chairperson of the BOD of each CU asking for their participation in the study. Fifty-eight CUs agreed to

participate in the study. Structured interviews were conducted at the premises of participating CUs or at conveniently located public facilities.

### Questionnaire

The questionnaire was developed after reviewing the CG literature. Questions were selected to gauge the competence and independence of SC members and key demographical information about participating CUs and SC members. Currently there are no uniform criteria for determining independence of SC members. Therefore, the National Association of Securities Dealers Automated Quotations (NASDAQ) standard, which is generally consistent with that of the New York Stock Exchange (NYSE), was adopted in this study and the dollar thresholds were adjusted downward to reflect local conditions. As such, SC members are classified as independent if they, their spouses, or children (1) do not currently work or have worked for the CU or its affiliates within the past three year; (2) have not received compensation in excess of \$60,000 for work other than service on the SC; or (3) are not partners, shareholders, or officers of a business with which the CU has significant financial transactions (\$200,000 or 5% of the revenues of such a business, whichever is higher).

Financial Literacy was operationalized using questions adapted from an instrument developed by "The Directors College, De Groote School of Business, Mc Master University, Ontario, Canada." The questions were pre-tested using seven subjects; one past member of the SCs of five CUs and two CU accountants, to ensure its suitability for the T&T context and to ensure that the questions were clearly understood by respondents. This process yielded on minor modification to the instrument. The final instrument is presented in Appendix 1.

Financial Expertise was assessed by asking respondents to indicate whether they or any other member of their CU's Supervisory Committee meet at least one of the criteria used by NASDAQ as indicators of financial expertise. These criteria are presented in Appendix 2. CU Size was operationalized by asking each respondent to place his/her CU into one of three size categories based on the value of its total assets as reported in its 2004/5 annual report. CU Charter Type was measured in two ways; firstly, by asking respondents to classify their CU as either organizationally-based or community-based. Secondly, each respondent was asked to describe the groups that are targeted by his/her CU for membership recruitment. These measures generated identical results.

### Data Analysis and Results

#### Demographic Profile / Descriptive Statistics

The sample comprised 30 male and 28 female SC chairpersons. Thirty percent of respondents were

between 20-40 years old, 32% were between 41-50 years old and 30% were over 50 years old. The age distribution of respondents did not vary significantly with either CU Type (Pearson  $\chi^2(2.58) = 2.57$ ,  $P = .277$ ) or CU Size (Pearson  $\chi^2(4.58) = 6.993$ ,  $P = .136$ ). The respondents were drawn from thirty-five (60%) organizationally-based and 23 (40%) community-based credit unions. The CUs ranged in size from small (18) to medium (21) and large (19). Most of the respondents (55) were educated to at least the Secondary level (See Table 1), and this pattern did not vary with either CU Size (Pearson  $\chi^2(4.57) = 4.60$ ,  $P = .331$ ) or CU Type (Pearson  $\chi^2(2.57) = 3.064$ ,  $P = .22$ ).

Females were better represented among small CUs (89%) than among medium (33%), and large CUs (28%) (Pearson  $\chi^2(2.57) = 16.765$ ,  $P = .000$ ,  $\Phi = .542$ ). Follow-up pair-wise comparisons were conducted to evaluate the differences among the population of small, medium and large CUs having female SC chairpersons. The results of these analyses are presented in Table 2. The Holmes' Sequential Bonferroni method was used to control Type 1 error at the .05 level across the two comparisons in the follow-up pair-wise analyses. Both the pair-wise difference between small and large CUs and that between small and medium CUs were statistically significant. It was at least 2.70 times more likely that the SC chairperson of a small CU would be female than it was for medium and large CUs.

**Table 1.** Demographics Characteristics of Sample

Characteristic	N	Mean	SD		
Supervisory Committee Size	57	1.51	0.85		
	N	Male	Female		
Gender of Supervisory Committee Chair	58	30	28		
	N	Primary	Secondary	Tertiary	
Educational Level Attained by Supervisory Committee Chair	58	3	21	34	
	N	20-30 Years	31-40 Years	41-50 Years	Over 50 Years
Age Distribution of Supervisory Committee Chair	58	6	11	19	22
	N	Mean	SD		
Financial Literacy of Supervisory Committee Chair	58	46%	15.6%		
Perceived Financial Literacy of Supervisory Committee Chair	58	66%	13.8%		
	N	Yes	No		
Financial Expertise of Supervisory Committee Chair	58	30	28		
Financial Expertise of Overall Supervisory Member	58	36	22		
Supervisory Committee Chair's Understanding of GAAP and Financial Statements	57	34	23		
	N	Yes	No		
Perceived Independence of Supervisory Committee	58	11	47		
Actual Independence of Overall Supervisory Committee	58	48	10		
	N	Organizationally-based	Community-based		
Type of Credit Union Charter	58	35	23		
	N	Small	Medium	Large	
Credit Union Size	58	18	21	19	

**Table 2.** Results of Pair-wise Comparisons Using Holm's Sequential Bonferroni Method  
Gender by CU Size

	Pearson $\chi^2$	Computed P-Value	Critical P-Value	Significant	Phi	N
Small vs. Medium-sized CUs	12.364	0.000	0.05	Yes	.563	39
Small vs. Large CUs	13.829	0.000	0.025	Yes	.620	37

## Preliminary Data Analysis

### Financial Literacy

The overall level of financial literacy among SC chairpersons was poor with a mean score of 46% (SD=15.6%). This suggested that the average SC

chairperson was not sufficiently familiar with more than 50% of the financial information contained in the financial literacy instrument. SC chairpersons' performance was not uniform across all areas of financial literacy. The mean scores on items dealing with responsibility for the proper preparation and

presentation of the financial statements (69%), the major sections of the Statement of Cash Flows (69%) and the calculation of the Net Operating Surplus of the CU (72%) were higher than the overall financial literacy score. Conversely, performance was especially poor on items dealing with the nature of deferred revenue and retained earnings and the actions that CU management could legitimately take to influence the CU's return on total assets. Interestingly, 72.4% of SC chairpersons rated the financial literacy of their committee members as acceptable or better (good to very good).

### **Financial Expertise**

Thirty of the 58 SC chairpersons (52%) met the criteria to be considered financial experts. This is interesting given the low level of financial literacy reported above. Most of these persons were considered experts based on having completed an accounting, auditing or finance programme (25), and/or having experience preparing, auditing, analyzing or evaluating financial statements of similar breadth and complexity as that encountered by their CU's financial statements (21). Consistent with this finding, 34 of the 58 (59%) SC chairpersons perceived themselves as financial experts having an in-depth knowledge of GAAP and the competence to apply GAAP. Furthermore, 22 of the 58 (38%) CUs had SCs with no member – chairperson or other – that was a financial expert. All other CUs had SCs with at least one financial expert [mean = 1.48; SD = .953].

### **Independence**

Only 11 of the 58 respondents met the independence criteria (19%). The primary reason for the lack of independence among SC chairpersons was their recent service on the CU's BOD or Credit Committee (43). This is an alarming finding given the critical role played by the SC in CU governance and the importance of independence to the effective discharge of their functions. It contrasts greatly with the finding that respondents perceived SC members as being very independent of the BOD and management (Mean 4.2 out of 5 (SD 1.10)).

Only forty-eight percent of SC chairpersons indicated that nominees to the SC are required to disclose their qualifications and experience. This finding seems at odds with the finding that most (57%) of respondents indicated that business and financial qualifications, and experience were the most important determinant of appointment of SC members, and another 21% indicated that these factors were important. It begs the question of how these qualities are assessed if nominees are not required to disclose them (to CU members). Most (47) respondents rated friendship and familiarity as unimportant considerations in the election of SC members.

### **Hypothesis Testing**

Two-way contingency table analyses were conducted to evaluate the hypothesized relationships between each of the DV, and the two independent variables, CU Type and CU size. The results were mixed.

### **Financial Literacy**

Financial literacy varied significantly with CU Type (Pearson  $\chi^2(1,58) = 4.531, P=.033$ ). The proportion of community-based CUs whose SC chairperson was financially literate was 56.5% compared to 28.6% for organizationally-based CUs. Hypothesis 2A is supported. Conversely, financial literacy was not significantly related to CU size. The proportion of small CUs with financially literate SC chairpersons (27.8%) was lower than that of medium-sized (47.6%) and large CU (42.1%). However, these differences were not statistically significant (Pearson  $\chi^2(2,58) = 1.67, P=0.435$ ). Hypothesis 1A was not supported.

### **Financial Expertise (overall)**

The proportion of SCs with at least one financial expert did not vary significantly with CU Type or CU Size (Pearson  $\chi^2(1,58) < 0.048, P > 0.874$ ). Roughly equal proportions of community-based CUs (48%) and organizationally-based CUs (46%) had at least one SC member that was a financial expert. Similarly, almost equal proportions of small (44%), medium-sized (48%) and large CUs (47%) had at least one SC member that was a financial expert. Hypotheses 1B and 2B were not supported.

### **Independence**

The proportion of SC chairpersons that were independent of the BOD and management did not vary significantly with CU Type (Pearson  $\chi^2(1,58) = .553, P=.457$ ). Hypotheses 2C was not supported. However, it was significantly related to CU Size (Pearson  $\chi^2(2,58) = 7.51, P=.023, \Phi=.36$ ). This finding is consistent with the significant positive correlation between the independence of SC chairpersons and CU Size ( $r = -.302, p = .02$ ). Follow-up pair-wise comparisons were conducted to evaluate the difference among the proportion of small (44.4%), medium (9.5%), and large (15.8%) CUs. The results of these analyses are presented in Table 3. The Holmes' Sequential Bonferroni method was used to control Type I error at the .05 level across the three comparisons in the follow-up pair-wise analysis. The only pair wise difference that was statistically significant was that between the small and medium-sized CUs. The probability of a SC chairperson being independent of the BOD and management was about 4.7 times more likely for small CUs than for medium-sized CUs. Hypotheses 1C was not supported.

**Table 3.** Results of Pair-wise Comparisons Using Holm's Sequential Bonferroni Method Independence by CU Size

	Pearson $\chi^2$	Computed P-Value	Critical P-Value	Significant	Phi	N
Small vs. Medium-sized CUs	6.199	0.013	0.05	Yes	.399	39
Small vs. Large CUs	3.633	0.057	0.025	No	.313	37
Medium-sized vs. Large CUs	0.358	0.550	0.0167	No	.095	40

## Discussion and Conclusions

This study assessed the competence and independence of SC chairpersons in T&T CUs. We also examined two sets of research hypotheses, namely, whether the competence and independence of SC chairpersons varies with (1) *CU size* and (2) *CU Type*. Among other things it was intended to provide baseline information that could be used to evaluate the effectiveness of the proposed fitness and propriety standards that will soon be required of CU officers.

Only one of the six hypotheses was supported. Consistent with H2B the SC chairpersons of community-based CUs were significantly more financially literate than their counterparts in organizationally-based CUs. This result supports our thesis that on average, community-based CUs are likely to have access to a larger pool of better educated, more financially literate individuals as potential SC members; and that they are more likely to recognize the critical role played by CG in the realization of CU mission, goals and objectives and therefore devote more and better resources to CG. Conversely, this thesis was not able to predict the financial expertise or independence of SC chairpersons suggesting that it is at best only partially correct.

Similarly, our thesis about the effect of CU size on the financial literacy, financial expertise and independence of SC chairpersons was not supported. CU size was not systematically related to SC chairpersons' financial literacy or financial expertise and the observed negative effect of CU size on independence is the opposite of what was predicted.

Taken as a whole, this pattern of results suggests that the determinants of SC competence and independence might be more complex than suggest by our theses. As such it may be necessary for future research to examine other factors that may explain the competence and independence of SC chairpersons including the possibility of an interactive effect of CU size and CU type.

There were several other potential important findings. Firstly, the overall level of assessed financial literacy was very low (42%), while the self-reported level of financial literacy was 66% (3.3 out of 5). The sizable difference between these measures may have adverse implications for the effectiveness of SCs. It suggests that SCs may not realize the extent to which they need help to properly discharge their responsibilities or may fail to fully appreciate the significance of financial issues that come to their attention. Secondly, the self-reported level of

financial expertise was higher than the assessed level of financial literacy. This suggests that SC members may have overstated their competence and or that self-reported formal qualification, which was the primary basis on which SC chairpersons were classified as financial experts may not be a reliable predictor. Thirdly, 38% of SCs had no member who was a financial expert. This finding taken together with the low level of assessed financial literacy is a cause for concern as the presence of SCs in CUs may be giving members a false sense of security about the financial wellbeing of their CU. Fourthly, the level of SC chairperson independence was very low (19%) largely due to SC chairpersons having recently served as members of the BOD or Credit Committee. To the extent that this is a reflection of the limited pool of persons that are willing to be CU officers, it signals a need for CUs to develop innovative officer recruitment and development programmes. Unfortunately, the chances of this happening seems slim as most respondents did not view their prior service as CU officers as a threat to their independence since 88% of them indicated that they were independent of the BOD and management. Fifthly, the large number of CUs that do not require officer nominees to disclose their competence for the positions being sought indicates that the nomination process at these CUs needs modification. Otherwise CUs are unlikely to consistently elect officers that meet the fit and proper criteria.

## Limitations

The findings of this study are subjected to a number of limitations. Firstly, the study focused on only one Caribbean country and only one group of internal stakeholders, the SC. As such the findings may not represent the situation in regional CUs as a whole or of other internal CU stakeholders – e.g., the BOD and general staff. Secondly, the study makes extensive use of the self-reported perceptions of SC chairpersons to evaluate the competence and independence of the entire committee, rather than relying exclusively on more objective measures. Accordingly the reliability and representativeness of the findings may be questioned. Thirdly, SC competence and independence were only measured at one point in time. This is not an ideal situation given the very dynamic nature of the task environment faced by CUs. Notwithstanding these limitations, the findings advance our understanding of the composition of SCs. At the very least, they are likely to stimulate interest in the area and may lead to further research. Any such

research should employ more comprehensive and objective competence and independence measures and include a larger number of stakeholder groups for a broader cross-section of Caribbean countries.

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### Appendix 1. Financial Literacy Instrument

For each of the multiple-choice questions below, choose the best answer. There is only one “best” answer for each question. Please record your responses on the answer sheet provided by circling the appropriate letter next to each question.

1. The accounting measurement basis for investments in marketable securities
  - a. could be either cost or fair value( market value) because the measurement basis depends on management designations of the securities as trading, available for sale, and held to maturity
  - b. is always at fair value (market value)
  - c. is always at acquisition cost, unless the investment is impaired
  - d. depends on whether the investee is a related party
2. Property, plant, and equipment (i.e., fixed assets)
  - a. appears on the balance sheet at cost less accumulated depreciation, except if the asset has been deemed impaired or has been revalued by management
  - b. appears on the balance sheet at fair value
  - c. appears on the balance sheet at historical cost less accumulated depreciation
  - d. appears on the balance sheet at net realizable value (NRV)
3. If a firm uses the indirect method for the Statement of Cash Flows (SCF), which of the following is true:
  - a. The SCF lists cash receipts from customers
  - b. The SCF shows cash spent for acquiring other firms, in the financing section of the Statement
  - c. The SCF shows stock issued to acquire other firms
  - d. The SCF shows the change in Accounts Receivable
4. Deferred revenue
  - a. represents the portion of Accounts Receivable that may be difficult to collect from customers
  - b. represents an estimate of the cash the firm may have to refund to customers if the customers return goods as defective
  - c. represents cash that has been received but for which the firm has not yet delivered goods/services
  - d. more than one of the above

For each of the multiple-choice questions below, choose the best answer. There is only one “best” answer for each question. Please record your responses on complete the answer sheet provided.

5. Retained Earnings on the balance sheet is an account usually referring to:
  - a. Cash and other liquid assets, generated by income, with which the firm can pay dividends.
  - b. cash generated by income, that the firm can distribute as dividends.
  - c. Part of the firm's owners' claims to net assets of the firm.
  - d. none of the above.
6. Which of the actions can management legitimately take to change the return on credit union assets by an amount that is immaterial (that is, small in relation to net income or total assets)?
  - a. Increase the Bad Debt Expense by a small and arbitrary dollar amount - whatever amount is needed to reduce current period earnings by the desired number.
  - b. Increase Interest Revenue by accruing interest on loans that are unlikely to be collected.
  - c. Defer maintenance on buildings and equipment until next year.
  - d. Change from an accelerated depreciation method to the straight-line method.
7. Who is responsible for the proper preparation and presentation of the financial statements?
  - a. Credit Committee
  - b. Management (with Board of Directors oversight)
  - c. External auditor
  - d. Supervisory Committee
8. Which of the following is NOT typically included among "current assets" on the balance sheet?

- a. Accounts receivable
  - b. Cash resources
  - c. Loans to members
  - d. Prepaid expenses
9. What are the three sections of the cash flow statement?
- a. Cash flow from operating activities, cash flow from investing activities and cash flows from financing activities
  - b. Cash flow from operations, working capital and capital expenditures
  - c. Cash flow from operations, asset sales and stock activity
  - d. None of the above
10. Which of the following is NOT usually a component of Member's equity?
- a. Retained earnings
  - b. Common good fund
  - c. Reserve fund
  - d. Members' deposits
11. Net surplus for the year is generally defined as:
- a. Total income less Total expenses
  - b. Interest income less Total expenses
  - c. Undistributed surplus less Dividends paid
  - d. Cash receipts less Cash payments
12. Using the following five-point scale, rate the financial literacy of each member of your Supervisory Committee by circling the most appropriate number next to each member:

	1	2	3	4	5
	Very	Poor	Fair	Good	Very
	Poor				Good
Member 1	1	2	3	4	5
Member 2	1	2	3	4	5
Member 3	1	2	3	4	5
Member 4	1	2	3	4	5
Member 5	1	2	3	4	5

### Appendix 2. Financial Expertise Criteria

Financial Expertise was assessed by asking each respondent to indicate whether he/she or any other member of his/her CU's Supervisory Committee meet at least one of the following criteria used by the NASDAQ as indicators of financial expertise.

1. Completed professional accounting, auditing or finance programme.
2. Served as a CEO/CFO of a business enterprise that is at least as complex as their CU.
3. Served as Senior Officer with financial oversight responsibilities for an organization.
4. Experience as a principal financial officer, principal accounting officer, controller, auditor, or similar position.
5. Experience actively supervising person(s) performing the duties of a principal financial officer, principal accounting officer, controller, auditor or similar position.
6. Experience overseeing or assessing the performance of companies or public accountants with respect to the preparation, auditing, or evaluation of financial statements.
7. Experience preparing, auditing, analyzing or evaluating (or supervising these activities) financial statements involving a similar breadth and level of complexity of accounting issues that one can reasonably be expected to be raised by your CU's financial statements.

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See for example the guidelines in the World Council of Credit Unions Best Practices in CU Supervision (2003); the Sarbanes-Oxley Act (2002); the International Federation of Accountants report on Rebuilding Public Confidence in Financial Reporting (2004) and [http://www.icc.wbo.org/CorpGov/Best\\_Practices\\_And\\_Codes.asp](http://www.icc.wbo.org/CorpGov/Best_Practices_And_Codes.asp)